

PACIFIC NORTHWEST DESIGN PROFESSIONAL LEGAL UPDATE

WASHINGTON OREGON ALASKA IDAHO

Spring 2010

RECOVERING ECONOMY BRINGS SHIFTS IN CLAIMS ACTIVITY

Design and Construction Attorneys

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With the arrival of spring, we at Skellenger Bender would like to share a few observations about trends that we have noticed in this shifting economic climate.

Lien Foreclosure Activity

First, the flurry of lien foreclosure litigation we saw last year has slowed considerably. Clients involved in some of these foreclosures experienced very mixed results. Some of the cases resulted in settlements that allowed our clients to recoup all or some portion of what they were owed by debtors; some resulted in our clients receiving long term security interests in real property with the hope of a future economic turnaround; others remain embroiled in litigation; and one case resulted in a significant "windfall" in which our client obtained a conditional ownership interest in property valued significantly higher than the debt. Under the circumstances, partial satisfaction or a secured promise of future payment was the best achievable outcome. Sometimes, particularly with small undercapitalized business organizations, a resolution was possible because the principal in the client venture agreed to discharge the debt using personal assets.

In almost all of our lien foreclosure actions, our clients had gone to great lengths to obtain payment. We were impressed with the

creativity and diligence shown in managing their outstanding accounts. They were willing to extend a helping hand by offering payment schedules, waiving interest charges and making other accommodations. However, in more than one case, the relationship between the contracting parties deteriorated to the point where attempts to contact the debtor became futile, and the filing of a complaint was seen as the only way to re-establish the lines of communication. Other times, the statutory time periods between the lien filing and the required foreclosure filing forced the inception of a lawsuit.

Although litigation is a drastic measure, it is also an effective way to bring an intransigent debtor to the negotiating table. This is because corporations, partnerships and other business associations are artificial entities that can act only through their agent. By statute, these artificial entities can appear in court only through licensed attorneys. Failure to appear through counsel can lead to a default judgment.

Contracting Practices

We know that design professionals have become savvier about their contracting practices. The heightened level of due diligence may already be paying off. We also know that design professionals have learned to

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appreciate their collection rights better, including both the downside of incurring fees and expenses in pursuing accounts receivable and the upside of finally securing payment or a security interest in lieu of payment. As a result of this economic downturn, design professionals have certainly learned and adopted better payment practices.

We continue to see first hand the direct link between good contracting practices and the ultimate ability of getting paid for the work. Firms that continue to work without tight and binding contracts are putting themselves at substantial risk, especially in these difficult times. Firms that do substantial work without receiving timely payment continue to incur unacceptable levels of risk. Very few firms can afford to serve as “banker” for the client; yet many, especially those working in the private development sector, continue to do so.

There are compelling reasons for including a number of payment-specific terms in the contract documents, including the right to stop work for non-payment and appropriate fee-shifting clauses for bringing claims for non-payment.

We continue to recommend that firms understand the financial underpinnings of any project before agreeing to perform work, including the debt structure on the project property. There is nothing wrong with discussing security for payment on risky projects. Reasonable business people understand the need for these discussions.

Finally, firms need to pay attention to lien rights and related notice of right to lien requirements, as well as to timely perfect liens when a lien makes sense and a lien is the only way to secure payment.

Underbidding Projects

We are starting to see an increase in disputes that arise as a result of contractual relationships between project owners and contractors where the contractor has deliberately underbid the work. In a design-build bid project, claims by the contractor against the owner can result in claims from the owner against the design firm. In design

-build projects, a contractor underbid can drag the designer into a contentious claim.

Projects are increasingly scarce and competition is fierce. For a contractor that has already trimmed its costs and profit margin, any remaining profit motive may ultimately yield to a more basic desire of remaining visibly productive and viable, so that the contractor will have an advantage when economic activity picks up again. If this is the goal, it can be all too tempting for the contractor to approach new projects with a claims-oriented mentality, searching for chances to make back profits through change orders, materials substitutions and other means.

One claims-generating technique that is used against design professionals involves looking for mistakes and ambiguities in project plans that can later be converted into opportunities to negotiate changes to the contract. This is particularly concerning if the design professional is a subcontractor to the contractor on a design-build contract. As soon as this happens, the contractor is no longer committed to teamwork and may force the design professional to share in the cost overruns.

Contractor underbidding, in and of itself, has very few legal ramifications, primarily because there is no independent cause of action for underbidding. In general, claims of unfair competition through underbidding lie only when the contractor relies on unlawful practices in order to underbid a contract. Examples include failing to pay workers' compensation, failing to pay prevailing wages, kickback arrangements and other fraudulent deals.

Litigation may also ensue in connection with federal contracts if underbidding is followed by the submission of false claims that are intended to make up the shortfall in profits. Again, the essential element is intentional, calculated underbidding that is tantamount to fraud. In most cases, however, the decision to underbid a project is not driven by nefarious motives, but is simply a business judgment -- albeit one that can have very real con-

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sequences for entities that are subordinate to the contractor.

Whatever the motivation for contractor underbidding, design firms are best served when they provide reasonable construction cost estimates to their owner-clients and when they counsel against awarding contracts to contractors who may have deliberately underbid the work. When a design firm's scope of work does not include construction management services, it is prudent for the firm to document the risks the owner may be taking. For example, even where the owner has hired an independent firm for construction management, design firms should not hesitate to communicate well-founded concerns with under-bidding, even though the bidding phase may not be part of the scope of work.

Green Building Risks

One area that is potentially ripe for claims due to underbidding is green building construction. A large number of green building projects are being undertaken with federal stimulus funds awarded by the General Services Administration (GSA). The acting administrator of GSA has announced that bids for many green building construction and retrofit projects have come in 8 to 10 percent lower than expected. The GSA has promised contracting reforms that will make it easier for companies to do business with the federal government. With a dizzying array of new technologies, new materials and new companies looking to make their mark, problems with underbidding are widely expected. In fact, skeptics anticipating future fallout from underbidding have already coined a new term -- "LEEDigation."

But there is still reason for design professionals to be optimistic: government agencies have indicated that the lower-than-expected bids have enabled them to fund additional projects. On balance, this is an exciting time for public contracting in the area of high-performance green buildings. Our advice to those entering design-build relationships is to know with whom you are partnering, do your due diligence and always make sure you review the prime contract.

We continue to be wary of contract documents that provide for the achievement of a specific level of green building certification. We are also concerned with the use of untested and risky design techniques in green buildings that could result in serious construction defect exposures.

Conclusion

These are very challenging times for design firms that see other industry players behaving recklessly and engaging in unsustainable contracting practices. It is all the more important to pay careful attention to risk management techniques. Those who do so will be best positioned to emerge from the recession with robust contracting skills for taking on new challenges.

William J. Bender
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SUCCESSFULLY NEGOTIATING GOOD CONTRACTS IN THE CURRENT ECONOMIC CLIMATE

A SERIES OF BREAKFAST ROUNDTABLES

In today's economic climate, design professionals and contractors have lost the leverage that they enjoyed in 2007 and earlier. Today, most work is being procured through public entities and private work is limited to a few active developers in certain limited market sectors. As a result, owners, both public and private, hold the leverage in contract negotiations; some are even telling design professionals and contractors that their contracts are "non-negotiable" and that they must either "take it or leave it".

So, how do you successfully negotiate good contracts in this business climate? This will be the topic of discussion at a series of breakfast roundtables presented by Skellenger Bender, P.S. As in past breakfast roundtables, the plan is to capitalize on the experiences and expertise of the attendees and then publish a summary of the captured discussions.



The Event Details

When:

- Wednesday, May 19th
- Tuesday, May 25th
- Thursday, June 3rd

Time:

7:30am—9:30am

Where:

Skellenger Bender, P.S.
1301 Fifth Avenue
Suite 3401
Seattle, WA 98101

Topics of Interest

- Negotiating tips
- Changes in the scope of work to account for increased risk
- Risk Fees
- Risk evaluation
- Problem indemnifications and what to do
- How to incorporate a limitation of liability into contracts
- How to negotiate design-build contracts
- The new Integrated Project Delivery (IPD) contracts; what you should know
- Understanding legal theories of unconscionability, contracts of adhesion, and other contract formation matters

To register, please contact Stephanie Correia by telephone or email (scorreia@skellengerbender.com). Please indicate your name, firm, phone number, email address and date preference. Space is limited for each morning so please be sure to indicate your preferred date.

NEWS AND UPCOMING EVENTS

April 2010

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Indemnification Clauses in Contracts

Hosted by American Council of Engineering Companies of Oregon

On April 20, 2010, Ms. Andrus and Mr. Scanlan spoke to an audience of ACEC engineers regarding indemnification clauses in Oregon. For a copy of this presentation, contact either attorney at bandrus@skellengerbender.com or tscanlan@skellengerbender.com.

Building Information Modeling, Integrated Project Delivery, Underground Utilities and E-Discovery: What Every Design Firm Should Know

Hosted by Kibble & Prentice and Skellenger Bender

May 11, 2010, Seattle, Washington

May 12, 2010, Portland, Oregon

This seminar will focus on risk management issues relating to BIM and IPD, underground utilities and E-discovery. To register to attend this seminar in either Seattle or Portland, contact Donna Snyder at (206) 695-3126 or professional.liability@kpccom.com. You can also find out more about the seminar at Skellenger Bender's website, www.skellengerbender.com.

Realizing BIM Potential for A/E Firms

Hosted by American Council of Engineering Companies

June 21, 2010 - June 22, 2010, Lake Buena Vista, Florida

This national two-day seminar focuses on BIM with many professional speakers. Ms. Andrus' session will focus on risk management, risk allocation and limitations of liability through contracting on BIM projects. For more information on attendance, please visit ACEC's website, www.acec.org.